FirstRand environmental and social risk assessment process
— 2023
FirstRand is committed to the effective management of the environmental and social risk associated with its lending and investment decisions.
Environmental risk includes climate change and nature risk. When lending and investment transactions are screened, social risks are also considered.

**Climate risk**
This is risk resulting from climate change, which causes an increase in physical risks (stemming from increased incidences of natural disasters), transition risks (resulting from changes in laws, regulations or customer preferences) and third-party liability risks (due to non-compliance with climate regulations).

**Nature risk**
Nature risk and climate risk are distinct but interdependent. Nature risk encompasses biodiversity loss and ecosystem degradation and can lead to potential threats to a company linked to its and others’ dependencies and impacts on nature. There has been a rapid decline in natural resources and processes (natural capital) which are critical for the stability of the planet.

As natural capital declines, nature’s capacity to provide ecosystem services* may be reduced temporarily or permanently, resulting in nature-related financial risks.

**Social risk**
Social risk relates to social impacts associated with activities of customers, investee companies or stakeholders resulting in financial, lending/financing, investment and equity interest exposure.

Social risks include issues relating to product responsibility and inclusion, labour, occupational health and safety, community involvement, community security, human resettlement, indigenous people’s rights and human rights.

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*Ecosystem services are benefits that people obtain from natural capital, such as air and water purification services, crop pollination and the breaking down of waste. Biodiversity underpins the flow of benefits.*
governance and management of environmental and social risk

Ultimate oversight of environmental and social risk rests with the board, reported through the risk, capital management and compliance committee (RCCC) and the social, ethics and transformation committee (Setcom). Progress and monitoring reports on risk management are submitted on a quarterly basis to the relevant committees, which are also responsible for the approval of related frameworks.

FirstRand has formal governance structures and processes for managing environmental and social risk. These include:

- enterprise-wide risk, social, conduct and ethics committees;
- detailed environmental and social risk due diligence for lending activities;
- reviewing the impact of natural capital risks on the group’s lending portfolios;
- managing direct operational environmental risk impacts; and
- a dedicated environmental risk management team that forms part of the group enterprise risk management function.

Refer to Basel Pillar 3 report for governance structure
https://www.firstrand.co.za/investors/basel-pillar-3-disclosure/
Risk management framework

The identification, management and mitigation of environmental and social risks are fully integrated into the group’s risk management processes. Environmental and social risks are not standalone risks and often overlap and amplify other risk types. The environmental, social and climate risk (ESCR) management framework is designed to identify, manage and mitigate the following risks:

- **Operational risk**
  - Climate vulnerability of infrastructure and business continuity risk
  - Impact of environmental issues on operating costs and revenues
  - Costs related to transitioning group infrastructure to low-carbon alternatives

- **Market risk**
  - Market-related risk due to environmental and social issues that may lead to changes in customer behaviours, market signals and increased cost of raw materials

- **Legal and regulatory risk**
  - Risks due to environment-related policy requirements such as the impact of carbon taxes, prudential requirements, emissions reporting requirements or exposure to litigation

- **Liquidity risk**
  - Risks related to changes in investor sentiment regarding the level of environmental and social risk management in the group, or climate-related activities (positive and negative) funded by the group, and the impact these may have in terms of accessing funding

- **Reputational risk**
  - Reputational risks due to environment-related issues such as shifts in consumer preferences, stigmatisation of a specific sector or increased stakeholder/shareholder concern, or negative feedback

- **Credit risk**
  - Environmental, social and climate-related risks associated with investments and client transactions, and the associated credit risk
  - Environmental, social and climate-related risks that may impact capital allocation, acquisitions and divestments, and the structuring of lending and investment portfolios

Governance and management of environmental and social risk continued
assessment of environmental and social risks in lending and investment

The group’s environmental and social risk assessment (ESRA) transactional due diligence process was implemented in 2009 and is integrated into the credit risk governance process. It identifies and assesses environmental, social, regulatory and reputational risks, to either FirstRand or its clients, with the potential to cause severe societal and environmental degradation as well as to negatively impact the ability of clients to meet their credit commitments.

ESRA:

1. Evaluates individual transactions and the client’s ability to manage environmental and social impacts associated with the funded activity, allowing the group to monitor its potential exposure to liability or risk.

2. Includes a built-in exclusion list and a restricted list of sensitive activities that the group will finance within limits (negative screening).

3. Requires compliance with all relevant local and national environmental, labour, health and safety and human rights legislation, as well as formal impact assessments, permitting and public commentary processes.

4. Includes climate- and biodiversity-related assessments to analyse key dependencies and impacts.

5. Transactions are automatically risk rated by means of an online ESRA process based on activity, which is followed by a judgement review by ESRA specialists who engage clients to ensure compliance with applicable regulatory requirements.

Climate and biodiversity screening

- The group has enhanced the review of climate-sensitive industries, in particular fossil fuels.
- The group uses externally developed tools to help with the identification and management of nature-related risk in credit transactions and investment decisions. Examples include Exploring Natural Capital Opportunities, Risks and Exposure (ENCORE), the Integrated Biodiversity Assessment Tool (IBAT) and the Partnership for Biodiversity Accounting Financials (PBAF) Standard.

The ESRA process is housed within the group environmental risk management team, which has resources in each of the business areas, allowing business unit specific transactional reviews. ESRA teams provide risk advice to the relevant credit committees regarding the environmental and social risks related to transactions.

The ESRA 2.0 system is an online platform which is accessible to all employees across FirstRand’s businesses and subsidiaries. The updated tool can be used on any group platform or interface, and provides automated workflows and time-stamped audit trails.

FirstRand conducts an annual ESRA monitoring review to measure the effectiveness of ESRA as an environmental and social risk management tool.

Broader Africa ESRA

ESRA is fully operational across the broader Africa subsidiaries. Within each subsidiary the ESRA process is supported by a localised policy which is governed by the group’s applicable frameworks and guidelines, national laws and regulations, industry best practices and international principles.

Training provided to employees:

To ensure continued effectiveness and to streamline efficiencies within the ESRA process, all new and existing employees involved in the ESRA process are provided with refresher training to assist them in fulfilling their responsibilities.

Each segment defines the training requirements for applicable staff members and, in conjunction with the FirstRand environmental risk team, develops relevant training programmes.

ESRA specialists also attend external courses, such as legal and risk courses that will assist with the application of the ESRA process.
**Scope of ESRA application**

ESRA is applicable to all material lending and investment transactions in the commercial, corporate and institutional segments and where use of proceeds is known, and for certain working capital facilities.

For transactions that meet Equator Principles (EP) criteria, an enhanced due diligence is conducted in line with:

- IFC performance standards;
- IFC sector-specific environmental, health and safety guidelines; and
- World Bank guidelines.

EP is an international standard for the management of environmental and social risks in large investment banking and project finance transactions.

**Scope of ESRA review related to transaction type**

- **Transaction screening**: determination of risk level and excluded activities checks
- **Desktop review**: environmental and social regulations
- **International standards**
- **Site visit (risk dependent)**
- **EP review when required**

For transactions that do not meet EP criteria, the due diligence process is as follows:

- **Transaction screening**: determination of risk level and excluded activities checks
- **Desktop review**: environmental and social regulations
- **International standards**
- **EP review when required**

**Scope of ESRA review related to transaction type**

- **Small business lending**
- **Commercial loans and asset finance**
- **Business loans involving property securitisation or finance**
- **Corporate loans**
- **Project finance**
- **Private equity**

**Environmental and social risk inherent in transaction type**

ESRA is not applied to transactions that are not considered material or where it is not feasible to apply an ESRA assessment. The following transactions are excluded from the ESRA process:

- Transactional banking (excluding facilities that fall into a high-risk industry)
- Personal loans
- Retail loans
- Settlement facilities
- Pre-settlement facilities
- Contingent facilities
- Working capital facilities where the use of proceeds is not known (not in the excluded and sensitive industry list)
- Category C transactions
**ESRA due diligence process**

Loan and investment screenings start when an application for debt funding or an investment is proposed. The ESRA tool is used to check whether environmental and social risks are applicable to the transaction and whether the activity is categorised as a high, medium or low risk. Medium- and high-risk transactions go through further due diligence processes before submission to the credit committee for consideration.

All sectors within the international sector industry code (SIC) listing have been pre-categorised according to an ESRA risk category using an online database of activities.

The ESRA process also considers whether

- the activity falls within the group’s risk appetite for exposure to sensitive industries; and
- involves new construction activities which trigger additional regulatory requirements.

Transactions are grouped into the following risk categories:

- **A (high risk)**: Activities with potential for significant adverse social or environmental impacts that are irreversible
- **B (medium risk)**: Activities with potential for limited adverse environmental and social impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures
- **C (low risk)**: Activities with minimal or no social or environmental risks and related impacts

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**ESRA process flow**

- **Roles**
  - Relationship manager
  - Environmental and social risk specialist
  - Legal teams and credit committees
  - Relationship manager

- **Stages of process**
  - ESRA screening of transaction
  - Application for credit/investment
  - Type of transaction ESRA applicable?
  - Review and analysis of ESRA risks and controls
  - Suggestions for covenants and warranties for loan documentation
  - Credit committee approval
  - Ongoing monitoring of covenants and warranties
ESRA is a prerequisite and a mandatory credit application component. If a client is in violation of administrative law, for example by lacking permits or not being compliant with the conditions and standards set by the group, the transaction team and FirstRand’s ESRA specialists work with the client to resolve this. Submission of an environmental and social action plan developed by the client may be required for compliance monitoring.

Dispute escalation and resolution
Where a decision on the way forward on a transaction cannot be reached due to the risks involved, the following escalation process is followed:

- The matter is referred to the group Chief Risk Officer (CRO) and applicable business risk official for consideration and approval in line with the group ESRA guideline requirements.
- If further discussions are required, an ad-hoc segment risk committee can be called for an out-of-policy decision.
- If an agreement cannot be reached at the ad-hoc committee, the matter will be referred to the group Executive Risk Committee before escalation to the group sustainability and governance executive committee.
- The outcome of the decision is noted at the applicable segment ethics and conduct committee, the FirstRand sustainability and governance executive committee and at Setcom.

ESRA covenants in loan documentation
After ESRA specialists have assessed a transaction for environmental and social risks, they consider whether covenants linked to compliance should be included in the loan documentation.

FirstRand’s legal department, ESRA specialists and relationship managers ensure that the following covenants are included:

- Compliance with all relevant host country environmental and social laws, regulations and permits in all material aspects.
- Warranties or related conditions to mitigate risks identified during the due diligence process.
- Client obligation to inform FirstRand of non-compliance with environmental legal requirements or any of the conditions of the facility.
- Client obligation to inform FirstRand of any claims against it or the operation arising out of non-compliance with environmental laws.
- Provision for termination of the agreement, at the discretion of FirstRand, if no adequate steps are taken to comply with environmental legal obligations or environmental conditions of the loan agreement.

Transaction monitoring
Monitoring is conducted on the transaction post-disbursement to ensure that all the appropriate environmental and social risk management covenants, warranties or conditions included in the loan documentation have been fulfilled and remain current.

Clients are required to report compliance with the conditions imposed in the loan documentation. If a client is not compliant, FirstRand will work with the client on remedial actions to ensure compliance to the extent feasible.

In the event of a monitoring breach or adverse risk incident, the overarching grievance and escalation process will be followed, and corrective actions will be monitored.

Non-compliance process

1. Receive
2. Acknowledge
3. Evaluate and investigate
4. Proposed corrective actions and resolution

Complainant accepts resolution
5. Implement joint resolution
6. Monitor corrective actions and close

Complainant doesn't accept resolution
5. Escalation for CRO decision
6. Ongoing engagement and mediation with complainant
7. Propose new corrective action and resolution
8. Implement joint or forced resolution
9. Noting at Setcom / ethics and conduct committee
10. Monitor corrective actions and close

Escalation process
The group’s excluded and sensitive activities and industries matrix was developed to guide the ESRA screening process. The matrix defines the industries which the group will not finance or invest in and provides restrictions for sensitive industries.

Restrictions are primarily based on the following considerations:
- activities may be illegal in terms of national or international laws and treaties;
- the group has agreed to financing restrictions imposed by financing agreements with Development Finance Institutions (DFIs);
- the group has made an ethical/moral decision not to be involved in certain industries which may be controversial, and which may cause reputational damage;
- internal risk appetite; and
- alignment with group strategy.

### EXCLUDED ACTIVITIES/INDUSTRIES

- No financing and/or investment possible

### SENSITIVE ACTIVITIES/INDUSTRIES

#### EXCLUDED ACTIVITIES/INDUSTRIES

- Funding and/or investment possible with restrictions, including portfolio limits
- Financing and/or investment possible, subject to an enhanced due diligence

#### SENSITIVE ACTIVITIES/INDUSTRIES

- Activities that are illegal by host country law or international agreement
- Activities involving ozone-depleting substances
- Trade in endangered wildlife, flora and fauna
- Unsustainable fishing methods
- Cross-border trade in waste (Basel Convention)
- Human rights violations
- Unbonded asbestos fibres
- Prostitution and pornography
- Activities involving the destruction of high-value conservation areas
- Seal hunting
- Racist and anti-democratic media
- Human rights violations

#### SENSITIVE INDUSTRIES WITH RESTRICTIONS/LIMITED EXCLUSIONS

- FirstRand will limit the extent to which finance and/or investment is provided to the following industries:

grievance procedure for external stakeholders

A grievance mechanism has been developed across the group, which enables external stakeholders to communicate queries or concerns relating to environmental and social aspects of activities and projects that the group finances.

All environmental and social queries relating to the group and its subsidiaries can be accessed using the links below:

- FNB Botswana: https://www.fnbbotswana.co.bw/contact-us/environmental-queries.html
- FNB Botswana: https://www.rmb.co.bw/contact
- FNB Eswatini: https://www.fnbswaziland.co.sz/contact-us/environmental-queries.html
- FNB Zambia: https://www.fnbzambia.co.zm/contact-us/environmental-queries.html
- FNB Lesotho: https://www.fnb.co.ls/contact-us/environmental-queries.html
- RMB Nigeria: https://www.rmb.com.ng/contact